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PUBLIC CAPITALIZATION OF THE INHERITANCE TAX

The whole capital of a nation is turned over once in every thirty-five years by the hand of death. In thirty-five years, by the grace of the all-powerful democracy and by its adherence to ancient custom, the whole wealth of the United States, tangible and intangible, worth at least one hundred and thirty billions, will pass from the powerful hands of those who now hold most of it to the weak hands of those whom the democracy loves little and fears not at all. The stupendous weight of \$130,000,000,000 is resting upon a foundation of ancient custom, and in this age the most ancient of customs are disintegrating. It is cheap to prophesy that year by year an increasing share of this vast sum will find its way into the coffers of the state.

Public appropriation of masterless estates may proceed slowly so long as the fiscal requirements are sufficiently provided through forms of taxation to which the public has long since adjusted the mode of its daily life. But there are new burdens to be assumed, and tremendous ones, just over the present horizon of the state. Pensions for the superannuated and disabled, relief for the sick, reformation of the outcast, subsidies for indigent motherhood, conservation of child life and of the human resources we now neglect through parsimony in educational effort are among the burdens which the state will in the end be forced to assume. Whether we approve or disapprove of the state assumption of responsibilities of this nature, as dispassionate observers of historical tendencies, we are compelled to admit that in every modern state the party of "social reform" is making rapid headway. There is in the existing social constitution no opposing force powerful enough to prevent the ultimate realization of part, if not of the whole, of the program of the social reformers. With the new fiscal burdens that will have to be assumed, new sources of revenue must be found, or old sources must be made more fruitful. It is a realization of this situation that fixes the eye of the democracy upon the vast mass of wealth passing each year from the able hands of its accumulators

to the hands of all but passive heirs. What profit shall the democracy fix for itself on death's turnover?

The theory of inheritance, in consequence of the acquisition of political power by the middle class, underwent a subtle, but significant, change. Under the conditions of an aristocratic society the privileges of inheritance carried with them the obligation to exercise certain functions of political and social importance. Propinquity or remoteness of relationship of decedent and heir had no bearing upon the political and social functions supported by an estate. If, then, the sovereign placed a burden upon inheritances, it fell, as a rule, upon all alike. Under the conditions of a mercantile or middle-class society, inheritance is a privilege shorn of obligations. No recognized social or political functions devolve upon an heir on his succession to an estate. Fulfilment of the decedent's wishes, expressed, implied, or imputed, becomes the sole recognized justification of inheritance. Accordingly the way lies open to a differentiation of burdens between heirs of differing degrees of propinquity. With the progress of commercialization state after state has accepted the principle of the differentiated collateral inheritance tax, until, at the present time, there is scarcely a country of any consequence that does not employ it, either in its national or in its local financial system.

Not less interesting than the steady advance of the collateral inheritance tax from one jurisdiction to another is the gradual transformation in structure that the tax is undergoing. A study of comparative rates of inheritance taxation leads frequently to baffling results. Many of the characteristics of a particular rate system must be referred to imitation of foreign laws, often evolved at an earlier time and under widely different conditions. We are able, nevertheless, to discern in the field of collateral inheritance taxation certain broad historical tendencies which have a bearing upon our inquiry. With the evolution of the tax, heirs remote in kinship come to be assimilated to strangers in blood, and the bounds within which the burden of the tax is relatively light tend to be drawn more narrowly.¹ In view of the fact that large estates

¹ The following table gives specimen rates for seven Anglo-Saxon jurisdictions and three jurisdictions of Continental Europe. The former, one may argue on general

frequently fail of direct heirs, these tendencies are manifestly in the direction of increased efficiency of the tax as a source of revenue.

Of far greater potential efficiency than the principle of differentiation of taxes according to kinship is the principle of progression, or differentiation according to magnitude, either of estate, as in Great Britain,¹ or of inheritance or legacy, as in most other countries. The progressive principle tends to restrict the burden of the tax to a small minority of the population; in a purely democratic state, therefore, it must almost inevitably gain acceptance. A century ago, the progressive principle could prevail only in democratic Switzerland. The growing political power of the property-less classes in other states has been attended by a parallel extension of the field of the progressive inheritance tax. All the important European countries, except Russia and Austria-Hungary, and a majority of our own states, now employ the progressive principle.

grounds, are much the more strongly influenced by tradition, the latter by contemporary logic. The former, with the exception of Kansas (itself not without obvious significance), show a fairly orderly progression from direct heirs to remote heirs. The latter show a tendency to assimilate heirs as remote as first cousins to the class of strangers, and to make a wide distinction between direct heirs and heirs even so near in blood as brothers and sisters.

	AMOUNT OF INHERITANCE	HEIR			
		Son	Brother	First Cousin	Stranger
		Per Cent	Per Cent	Per Cent	Per Cent
New York	\$200,000	1.69	1.69	6	6
California	"	2.50	3.75	7.50	12.50
Illinois	"	2	2	4	10
Kansas	"	4	10	12.50	12.50
Massachusetts	"	2	5	5	5
Wisconsin	"	2.50	3.75	7	12.50
Great Britain	£ 40,000	4.50	7.50	9.50	14.50
German Empire	M. 1,000,000	0	10	20	25
France	Fr. 1,000,000	3	12	15.50	18.50
Italy	1,000,000 lire	3.60	10	18	22

The rates for American states are taken from Lee, Higginson & Co., *Inheritance Taxes of All the States*, 1911; the rates for European countries are from West, *The Inheritance Tax*, 2d ed., 1908. The percentages for Great Britain are arrived at by combining estate duties with legacy duties. The percentages for New York are obtained by reducing complex rates, involving abatements, to simple percentages of the whole inheritance.

¹ The employment of the graduated estate duty is obviously a natural consequence of the principle of primogeniture.

Its efficiency for the present is greatly reduced by the fact that it is somewhat illogically¹ ingrafted upon the principle of differentiation of tax rates according to kinship. There can, however, be no doubt that the progressive inheritance tax finds general favor in the modern state and will increase its efficiency at need.

For the public appropriation of inheritances we have, then, the requisite instruments ready to our hands. We have well-trying principles of financial legislation, we have a social situation favorable to their application. Last, and perhaps least, we have plausible ethical arguments for the tax, to suit the varying taste. The inheritance tax will preserve the individual heir from the demoralizing influence of great riches, according to Mr. Carnegie. According to Mr. Roosevelt, it will preserve society from the corrupting influence of hereditary wealth. The inheritance tax will place the state in its legitimate position of coheir, according to Bluntschli. It is essential to the realization of the faculty principle in taxation, according to Professor Seligman. All these arguments are effective, each in its own way, in dispelling whatever remains of the traditional feeling that what a man has acquired, under the law, he has a right to transmit unimpaired to his heirs.

To Adam Smith and his immediate successors the inheritance tax presented one serious defect: it is an unthrifty tax, falling not upon "revenue," but upon capital, and hence tends to deplete the national stock of parent wealth. If this view of the matter is valid, the progress of inheritance taxation as a source of ordinary revenue cannot be regarded as an unmixed good. Admitting, as we must, that the maintenance of the national capital stock is not in itself the highest end of social policy, and that we must at times accept capital depletion as the legitimate cost of a higher good, we are yet not justified in overlooking the fact that the dissipation of accumulated capital is a social cost which should be reduced to

¹ It seems probable that the socio-psychological principle underlying the collateral inheritance tax is of a character analogous with that which underlay escheat, while the principle underlying progressive taxation is equalitarianism. There is no logic in progressive escheat, as exemplified in the laws of some of our states, which confine the progressive principle to collateral inheritance alone. Nor is there any logic in differentiated equalitarianism.

a minimum, so far as this is possible. This point, I assume, scarcely requires argument, as the social-economic value of thrift is one of the best-established values of economic theory. Our approval of the thrifty savings bank depositor rests not wholly upon admiration for his personal qualities; nor upon the assurance his conduct gives us that he will never burden our poor rates. It rests in large part upon our belief that his small contribution swells our financial power, helps to equip us with the buildings, materials, and implements needed in production. Our disapproval of the man of fortune who transforms his capital into a life-annuity, to insure himself against the chance of leaving any part of it unspent, has no valid ground except our abhorrence of the destruction of accumulated capital. One of our most effective apologies for existing inequalities in the distribution of wealth rests upon the fact that income widely diffused is easily absorbed by current expenditure, while income that is highly concentrated, even in wasteful hands, almost inevitably gives rise to accumulations. Critics of the socialistic plan of social reorganization never fail to point out the difficulties that a socialistic state would encounter in finding a satisfactory substitute for private interest in the function of maintaining and developing the social capital fund. In our zeal for the establishment of a system of taxation which we approve on general social grounds, we may attempt to minimize the importance of maintaining capital intact.¹ It would appear to be more in keeping with sound economic principle to admit that if the inheritance tax is necessarily an unthrifty tax, it should be applied with great moderation. Current political tendencies, however, offer us no assurance that the inheritance taxes of the future will be characterized by moderation.

There are conditions, as Mill pointed out, under which the charge of unthrift will not stand against the inheritance tax. If the proceeds of the tax are employed for the purpose of paying off the public debt, the effect of the tax is merely to transfer capital from one body of citizens to another.² If the inheritance tax

¹ As does West, *op. cit.*, p. 210.

² Dr. Max West, *op. cit.*, pp. 49 and 53, cites two instances of inheritance taxes levied with the special purpose of paying off public debt.

revenues are used to defray expenditures that would otherwise have to be met by public borrowing, the effect is the same.¹ Doubtless there are many instances in which inheritance taxes can be shown to present this comparatively thrifty character. Nevertheless no student of financial history would care to assert that inheritance taxes are commonly put to such uses. They are levied, as a rule, in lieu of other forms of taxation, or in support of services that would not otherwise be undertaken. There is no reason for supposing that the public debts of European countries would increase more rapidly without the inheritance tax; nor is there reason for supposing that the enactment of an inheritance tax law in the United States would result in the more rapid extinction of our debt. The modern state is quite able to live up to its ordinary revenues.

If a state levies an inheritance tax, the burden of other forms of taxation may of course be lightened. Ordinary taxpayers, finding their incomes virtually increased, will be in a position to increase their savings. Thus the dissipation of accumulated capital that may be occasioned by the tax will be offset, it is often argued, by new accumulations. This argument overlooks the fact that very large classes of society are of a low order of thrift, and that remission of the taxes that fall upon them would result not in increased saving, but in increased consumption. How large an accumulation would be occasioned by the remission of ten million dollars of taxes upon tobacco or alcoholic beverages or coffee or sugar? Certainly not ten millions; probably not one million. A remission of an equal amount of taxes falling upon large incomes exclusively would doubtless produce a larger accumulation. But it is not in the nature of the political tendencies which are forcing the enactment of inheritance-tax laws to employ them as a means for reducing the burden upon large incomes. If any taxes are to be remitted as a consequence of inheritance taxation, these will doubtless be the taxes of wide incidence, the remission of which will exert scarcely a perceptible influence upon accumulation.

¹ The federal inheritance tax of the Spanish War period may be regarded as of this character. We raised what we could by taxation, and borrowed to meet excess of expenditure. But for the inheritance tax we should have borrowed more.

We are therefore justified in assuming that the sums raised by inheritance taxation practically represent a net reduction in our fund of accumulated capital.

With rates of inheritance taxation so light as they are in most of our states, the tendency of such taxes to trench upon accumulated capital may be almost negligible. In the United States inheritance taxation is in an incipient stage; it cannot be expected to produce marked effects of any kind. It is worth while, however, to consider how we shall stand when our legislation has overtaken that of Great Britain—a country which still lays claim to exemplary moderation in most fiscal matters. The United Kingdom now collects in inheritance taxes about £25,000,000. The population of the United Kingdom is about half that of the United States; the wealth of the former nation is probably not more than 60 per cent of that of the latter. Probably a somewhat larger proportion of the wealth of the United States is represented by small estates that would benefit largely by exemptions and minimum rates. On the other hand, we have probably a larger proportion of our total wealth in very large estates which would bear maximum rates. We cannot therefore be far wrong in assuming that inheritance taxes levied at British rates would yield \$200,000,000. Would this be a negligible deduction from our funded capital? The average annual addition to our savings-bank deposits, for the last decade, does not exceed \$150,000,000. The combined activities of our ten million savings-bank depositors would fall far short of making good the loss in capital funds that a fairly moderate inheritance tax would occasion.

It may be said that such a comparison does not assist us in gaining a properly proportioned view of the problem as a whole; that we should compare the amount of the tax, not with the yield of any one source of accumulation, however significant in itself, but with the entire annual increment in the national wealth. Such a comparison, it may be thought, will show that we have no reason for concern over the possibility of capital depletion.

According to census estimates—none too reliable, it is true—the wealth of the country increased from \$42,000,000,000 in 1880

to \$88,000,000,000 in 1900, or nearly 110 per cent. If we assume that the wealth of the United States in 1910 was \$125,000,000,000, the increase for the decade amounted to 42 per cent. It is probable, however, that the figure \$125,000,000,000 is too low; quite possibly our wealth is still increasing at the rate of 5 per cent per annum. Only 3 per cent of our wealth passes through the probate courts each year. Suppose now that we levy an inheritance tax equal in weight to that of the United Kingdom; it would absorb only about 6 per cent of all inheritance. And this amounts to hardly more than $3\frac{1}{2}$ per cent of our annual increase in wealth.

But the annual increase in wealth is not a true measure of the annual accumulation from income. Much of the annual increase consists merely in the revaluation of lands, mines, movable goods, even intangible privileges. If our wealth increases six billions this year, how much of the increase is due to the thrift which diverts purchasing power from current consumption, and employs it to provide new materials and instruments of production? One-third? For my part, I should not dare to credit thrift with a larger contribution.

The inheritance tax rests upon the entire mass of wealth, including that which originates in unearned increment as well as that which originates in saving. But the state does not take from a given inheritance, proportionate shares of the lands, reproducible goods, franchises, and other privileges that compose it. The public authority demands money, and this is drawn, in one way or another, from liquid capital. The whole of the inheritance tax, then, is paid out of the fund of fluid, mobile capital which is the sole financial basis of the goods which conserve or increase our productive equipment—the fund of which it may properly be said that it originates in saving. Accordingly, an inheritance tax which should absorb $3\frac{1}{2}$ per cent of the aggregate annual increase in wealth would dissipate far more than $3\frac{1}{2}$ per cent of the annual increase in the fluid fund of productive capital. If I am right in my estimate that increase in the latter fund does not exceed one-third of the increase in national wealth, a 6 per cent inheritance tax would consume $10\frac{1}{2}$ per cent of our current annual accumulations from income. The capital-destroying power of a tax rate which we may

at any time borrow from our British kinsmen is, then, far from being negligible.

There is, moreover, no valid reason for supposing that the British inheritance tax has reached the climax of its development; nor that, when once we set about it, we shall regard ourselves as limited by British precedent. The British law of 1907 was not accepted very gracefully, to be sure, by the classes upon whom the burden of the new taxes rests. Nevertheless, it is difficult to see why practically all the rates could not be made much heavier; most of them might be doubled without serious hardship to anyone. Now, to levy inheritance taxes in the United States at rates 100 per cent above those of the present British taxes—something we may quite conceivably do before many years have passed—would be to absorb over 20 per cent of our national increase in accumulations from income, even if our present rate of increase can be maintained indefinitely.

It would, however, be hazardous to assume that accumulation in the United States can continue indefinitely at the present rate. Our large savings from income may be explained, in part at least, by economic conditions which are manifestly transitory. Our working class, recently transplanted from a less fertile economic field, secure incomes in excess of their accustomed needs, and accordingly have a surplus for accumulation. Our men of wealth, newly enriched, have not, as a class, acquired the art of luxurious consumption. Their incomes outrun their expenditures, and the surplus accumulates without active effort on their part. New opportunities presented by nature or created by society have always been available and have served as an additional stimulus to thrift. One cannot gain title to a homestead, one cannot seize and exploit coal lands or street-railway franchises, without the control of funds accumulated from income. Rarely, in a rapidly developing economic state, is it possible for an entrepreneur to draw from pre-existing funds all the capital requisite to a full exploitation of his opportunities. He must supplement the funds which he already owns and those which he can borrow with funds saved from his current income, if he is unwilling to forego many chances of great profit. "Unearned increment" thus serves as a premium upon thrift.

As our economic conditions become more settled the unearned increment loses much of its potency as a stimulus to thrift. Furthermore, our laborers are raising their standards of living and our capitalists are learning the ways of a society which knows how to spend its income. How soon the rate of accumulation will begin to decline, and how rapid the decline will be, we need not attempt to predict. For our present purpose it is sufficient to point out that a tax rate which would today absorb 20 per cent of our annual accumulations would absorb a much larger percentage of the annual accumulations of, say, 1964.

Granted, then, that the evil of unthriftly inheritance taxes is negligible at the present time, when the taxes are light and the rate of accumulation is high. Such taxes, nevertheless, are destined to become heavier and the rate of accumulation is destined to become less. The evil, obviously, is one which has the capacity of growing into importance.

If the inheritance tax is indeed affected with the vice of unthrift, and if the defect may lead to such serious consequences as have been indicated, it might be thought to be the part of wisdom to abandon the tax altogether, or to restrict it to so narrow a range that its power of destroying accumulated capital would be negligible. To propose such a restriction of the tax, however, would be idle, in view of the powerful social and political forces to which its development responds. Economists may urge the necessity of capital conservation, but the democracy will be slow to recognize such necessity, so long as the alternative to a policy of public dissipation of capital is the perpetuation of vast private estates. Must we accept this alternative? There seems to be no good reason why we should. There is nothing in the nature of the state which requires it to assume the rôle of a prodigal heir who squanders his inheritance upon current needs instead of administering it prudently with a view to its future increase. The state can adopt the same policy which every prudent person recommends to the private heir. It can treat capital acquired through inheritance as a fund to be maintained intact. Let the state set apart, as a permanent investment fund, the proceeds of all inheritance taxes, and depletion of the national capital will at once cease.

So obvious a solution of the difficulty must of course have presented itself to almost every student of public finance. It does not, however, appear in the textbooks; nor in other literature easily accessible to the general student of taxation.¹ For this omission I would assign two reasons: first, income from a capital is not commonly regarded as an appropriate form of public revenue; and second, the state is not regarded as an appropriate agency for the investment and administration of capital funds.

A proposed policy of securing a public revenue from an invested capital would be attacked by exponents of traditional liberalism on grounds both fiscal and political. Such a revenue, they would urge, is speculative and uncertain; if of considerable magnitude, it would tend to liberate the executive from the control now exercised by the representatives of the people through their power of granting or withholding supplies. The fiscal objection, evidently, would once have been valid; it is now obsolete. One hundred years ago there were relatively few capital investments which presented the characteristics of security and regularity of revenue. The public obligations of even the richest state were less securely based upon national financial power than are those of the weakest of the great powers of today. British obligations of 1812 were inferior to Italian or Japanese obligations of 1912. Sound municipal and private corporation paper hardly existed one hundred years ago. Today there exists a vast volume of sound paper, public and private. Any state with funds to invest would be able to possess itself of a perfectly stable revenue.

The political objection to a revenue of this nature may also be pronounced obsolete. Future executives will, no doubt,

¹ I have searched diligently for it, but without success. The nearest approach to it I have found is Professor Adams' suggestion that inheritance taxes, being "income of property," should not form a part of the revenues employed to meet ordinary expenditures, but should be set apart for special purposes, such as education, and especially higher education (*Science of Finance*, p. 550). Accepting Professor Adams' classification of expenditures for higher education as "developmental," we may look upon the application of the inheritance tax to such uses as an exchange of material for immaterial productive powers. Professor Adams, to be sure, gives no such reason for his proposal, and it probably is based upon no such recondite principle as the foregoing, but upon the practical principle of liberating the state university from the biennial anxieties attending the passage through the legislature of the appropriation bills.

encroach at times upon the powers of the legislature, and manipulation of the appropriations will continue to be an effective mode of legislative resistance. But no future legislature, engaged in a constitutional struggle, will attempt to starve the whole public service in order to bring the executive to its terms. Such a proceeding would be possible only with that best of governments which governs least; with a government administering chiefly traditional services the omission of which would occasion no permanent social injury, such as a royal civil list in a democratic state; a standing army in a country protected by geography from all serious attack; a navy for the protection of an ocean shipping that does not exist; foreign embassies of a country which does not endow its ambassadors with the minutest discretionary powers. The modern state, with its wide range of functions requiring continuous exercise, can safely charge some of them upon a funded income. The service of education is a case in point. No one would deny that a reasonable degree of independence from legislative whim would improve the service. If the state university enjoys any advantage over the endowed university, this advantage certainly does not consist in the fact that a quarrel between the executive and the legislature may at any time deprive the state university of means to carry on its work.

More serious objections can be urged against the employment of the state as an agency of investment. It may be argued that the state is not likely to make investments wisely, that its entry into the market for investments would prejudice the interests of the private investor, and that a state with large funds to invest would be in possession of new and dangerous powers.

There can be no doubt that in the past public management of productive property has often been extremely wasteful. The federal government, in its administration of its vast landed estate, followed no principles remotely resembling those followed by a prudent private investor. State administration of the property represented by the school lands commands scarcely more admiration. But land, and especially undeveloped land, is one of the most difficult of properties to administer. Private interest and initiative are needed here, if anywhere, in our economic system.

The record of state administration of moneyed funds, on the other hand, is by no means uniformly discreditable. The school funds of the various states are, at the present time, fairly well managed. No serious criticism is brought against the administration of funds by the governmental savings banks of European countries, nor against the quasi-governmental administration of insurance funds in the countries which have adopted the plan of working-men's insurance. An examination of the financial statements of endowed universities in America¹ will indicate that their funds are, as a rule, administered with due regard to both security and productiveness. The truth seems to be that it requires no superhuman shrewdness to invest funds safely, even in vast amounts, so long as exceptional returns are not demanded. We have already succeeded in developing a tradition of management in our federal treasury department which assures us that our temporary surplus funds will be managed as well as the law permits—at times somewhat better. The administration of vast permanent funds would naturally make it necessary that we should secure for the service of the state a body of officials of sound financial training. This should not prove impossible in a country like the United States, where financial ability is far from a monopoly of the few.

The policy which is here defended would involve the investment by the state of hundreds of millions annually. The state, it may be urged, would thus become a formidable competitor of the private investor who seeks to place his funds in safe securities. This would indeed be a serious matter if the volume of such securities were small and incapable of expansion. Modern financial institutions, however, have provided us with a vast volume of securities of unquestionable soundness. The supply of such securities can, moreover, be increased almost at will through the devices of preference differentiation of the income claims resting upon a given property, by the diffusion of risks, and by the more thoroughgoing application of insurance principles. A sufficiently large part of our \$130,000,000,000 of wealth can be thrown into the form of safe

¹ These are, to be sure, private institutions, but since they are no more under the dominance of the private economic motive than the municipalities their experience is in point.

investments to meet all probable requirements, public and private. But let it be granted that, on account of public competition for investments, the private investor desiring a given return would be forced to enter a field of somewhat higher risk than at present; that he would be compelled to exercise his skill and judgment to escape chances of loss. Is not the necessity for the exercise of such qualities, after all, the principal social-economic justification for the private enjoyment of income from capital?

A public investment policy, however extensive, would encounter no insuperable economic obstacles. If there are valid objections to such a policy, they must rest upon grounds of a social and political character. It is not to be denied that grave objections of this order do present themselves the moment one gives thought to the subject. Were a state to build up an invested capital it would be in possession of a financial power of its own to oppose to that of private finance. In its investment policy it might pursue ends other than those of financial gain, and so work important changes in the social structure. With the relatively small volume of surplus funds under his direct control, the secretary of the treasury has already become a power of no inconsiderable magnitude in our financial markets. Suppose that a federal bureau were vested with the control of funds running into the billions; what mischief could it not wreak in Wall Street! The public savings-bank funds of Belgium and the working-men's insurance funds of Germany are at present used in part to encourage the building of cottages for working-men. Had we an investment fund of colossal proportions, what an objective for the strategy of militant agrarianism! A state investment policy is manifestly not one to be lightly accepted, even if fiscally practicable and economically sound.

Concentrated financial power, let us admit, is real power. Its proper employment is a potent instrumentality of social progress; its improper use is socially and politically disastrous. There can be no guaranty that public financial power would never be abused. We have, at present, a high degree of concentration of financial power in private hands. If it were possible to prove that such concentration is never subject to abuse, the case against public acquisition of financial power would be a strong one.

Those who assert that private financial agencies can never abuse their powers rest their argument upon two assumptions: that the competition between different financial groups is sufficiently active to render those who are in need of funds independent of any single group; and that privately controlled funds flow automatically to the fields offering the highest returns compatible with safety. Were these assumptions valid, we should be justified in holding that private financial power is essentially mechanical, governed by impersonal economic forces; that the great financier, in spite of his apparent position of personal power, is a mere agency of forces beyond his control, an agency devoid of all discretionary power. But neither assumption is wholly valid. The great financial houses do not, as a fact, compete actively for the privilege of underwriting a great public or private loan. The conduct of the agents of bonding houses in bidding for the loans of small municipalities and local corporations is frequently indicative of the existence of the "gentlemen's agreement." The monopoly of financial power is never absolute, it is true; there still remain multitudinous minor sources of investment funds that may be drawn upon when the great financiers withhold supplies. A government which finds it difficult to deal with the financiers may float a popular loan. A local corporation may solicit funds among its patrons and employees. None the less, it is pretty generally recognized that it is better to have the financiers with you than against you. And this is the recognition of a power not wholly held in restraint by competition.

Nor is the second assumption, that the flow of private funds is directed solely with a view to securing the maximum economic gain, to be accepted as of unquestionable validity. Let us imagine that a single financial group controls the greater part of the flow of free capital to a section of the country which is still in the developing stage, and hence dependent upon foreign funds. Is it to be supposed that the flow of funds will be distributed impartially to all who are in need of them and can give appropriate guaranties? Or are we at liberty to suppose that certain local captains of industry will find special favor, and that competing captains will be forced to content themselves with what funds they can secure from less powerful lenders? Must we suppose that the private dispen-

sers of capital funds will provide them as readily for the policy of productive public undertakings, which they may happen to detest, as for the approved policy of unproductive improvements? There are able financial writers who will assert that no legal proof of discrimination in the dispensing of domestic investment funds can be adduced. Very well, I confine myself to instances presented in hypothetical form. Let it be noted, however, that the same financial writers to whom I refer are the last to deny political and social potency to the "dollar diplomacy." They would be the last to assert that nothing beyond the desire for a sound investment induced our financiers to seek the privilege of refunding the Honduras debt, and of participating in the Chinese loan. On the contrary, these activities, it is universally agreed, present a character of broad statesmanship. Let us grant that financial statesmanship has hitherto been confined to the field of foreign affairs. There appears to be no natural reason why it should not, in future, concern itself with domestic affairs as well.

Financial power, we may repeat, is a real power in the political and social fields. It may be directed against the state as such, but I know of no reason for believing that it is often employed in this way. It may be directed against particular private interests in the state. Such employment of private financial power is probably not uncommon; possibly it is of no concern to the state.¹ A considerable financial power, lodged in the state, might reduce the possibility of iniquitous financial discrimination against individuals. It would certainly liberate the government itself from an improper dependence upon private interests. With an abundant supply of public investment funds at hand, no city desiring to municipalize its public service industries would find its projects subject to a private veto. Doubtless an unseen third chamber, the bondholders, has often proven a socially expedient branch of

¹ To employ a somewhat treacherous analogy, the private military power of the feudal lord was seldom directed against the king. It was frequently directed against other feudal lords—a matter not regarded as of special concern to the king. In the end, however, it became expedient for the king to assume the rôle, first of paramount, later of exclusive, military power. Not to press the analogy too far, it is conceivable that the time may come when the state, to maintain its position as the predominant influence within its own boundaries, will be compelled to assume the rôle of an important, if not paramount, financial power.

government. But no political scientist is ready to give it a permanent place in his system. The adoption of a policy of nationalization of railways in the United States would give a permanent place in our government to such a third chamber, unless the public possessed funds of its own wherewith to finance the venture.

It remains to consider whether the state, in the pursuit of non-economic ends, would be likely to follow a policy of unproductive placing of funds. There is a widely current doctrine that the state, because it is eternal, or because it is not a business concern, does not need to seek a profit. If this means simply that the state may often be content with an immaterial return in social utility which would not serve as an adequate reward for private enterprise, no objection to the doctrine need be raised. But it is often interpreted in a literal sense. Provided the state possessed a surplus revenue, many persons would see no reason why it should not build roads and canals the returns from which, material and immaterial, so far as calculable, would never exceed maintenance charges. The only explanation for the prevalence of such a doctrine must be that many persons are unable to realize that productive funds are necessarily limited in amount and should therefore be placed only where they may be expected to be normally remunerative. Any other policy is sheer waste, whether public or private. Now, no one would advocate the placing of a permanent investment fund in the control of the state if the inevitable result would be merely to extend the range of profitless economy.

There is, however, a simple means of insuring a reasonable regard for profit in the investment of public funds. Charge upon the return from such funds governmental services that are continuous, that make a powerful appeal to the ordinary citizen, and the beneficiaries of which are widely dispersed through the population. Such a service we already have in popular education. Still better, from the point of view of controlling a public investment policy, are those services which will arise when, like other civilized nations, we shall assume the responsibility of social insurance. The general public would show little tolerance of an uneconomical administration of capital funds the revenues from which were set apart for the support of the aged and the disabled, the widowed mothers of young children and other natural dependents of society.

The endowed hospital of today, though a philanthropic institution, makes no pretense of philanthropy in its investment policy. The fact that the beneficiaries of the hospital endowment funds are among the most needy of mankind is a sufficient protection to trustees against the temptation to sacrifice on sentimental grounds either security or productiveness of investments. Mention has already been made of the fact that in Europe public or quasi-public funds are employed to assist in the provision of working-men's houses. The conditions under which loans are made to working-men are not, however, philanthropically mild. In security such investments compare favorably with investments in public obligations; in productiveness they are superior. A public authority, intrusted with the administration of funds, would no doubt endeavor to strengthen its political position by employing them in such a way as to secure incidental social gains. With conditions of security and productiveness equal, it might prefer farm and building loans to railway or industrial loans. It is not clear, however, that such preferential treatment of the entrepreneur of small means would be undesirable. It might correct the tendency of private financial powers to favor the large enterprise.

The public capitalization of the inheritance tax would tend to conserve the national stock of productive wealth. It is a policy that would encounter no insuperable administrative difficulties; it would not seriously prejudice the interests of the private investor. Politically and socially such a policy, if it has potentialities for evil, would appear to have far greater potentialities for good. None the less, the proposal of such a policy will by some economists be regarded as revolutionary.

There is manifestly nothing revolutionary in principle in a capital fund owned and managed by the state for the benefit of a particular public service. Instances of such funds have already been cited. Public and semi-public endowment funds now in existence in this country amount, in the aggregate, to an imposing sum. We are living in an epoch in which the funded endowment is employed with growing frequency. There is an increasing reluctance on the part of private donors to contribute funds merely for current expenditures; there is an increasing tendency on the part

of public and semi-public institutions to transform extraordinary current receipts into permanent endowment. Not on principle, then, can a plan of the permanent endowment of a public service be treated as revolutionary. If there is anything revolutionary in the plan, it must consist solely in the magnitude of the operations that it would entail.

In an earlier paragraph it was estimated that inheritance taxes levied at rates equivalent to those of Great Britain would yield \$200,000,000 a year. This estimate was based upon a rough comparison of the population and wealth of the two countries. If we assume that the wealth of the United States is \$130,000,000,000, the amount passing through the probate courts each year will be somewhat less than \$4,000,000,000.¹ It would require only an average rate of 5 per cent to produce a revenue of \$200,000,000. Of the \$4,000,000,000 of annual inheritances \$2,000,000,000, let us say, will fall in estates of \$50,000² or less, and could bear only a low rate. An average rate of 2 per cent on this \$2,000,000,000 would yield \$40,000,000. Of the remaining \$2,000,000,000, three-fourths would fall in estates of \$50,000 to \$1,000,000, and could safely bear an average burden of $7\frac{1}{2}$ per cent, which would yield \$112,500,000. The remaining \$500,000,000, in estates of \$1,000,000 and over, could pay an average rate of 15 per cent, and would yield \$45,000,000. On this basis we should have an aggregate revenue of \$197,500,000. Making all due allowance for error in rough estimates such as we are forced to rely upon, it still appears clear that the yield of an inheritance tax levied at the fairly moderate British rates could not be far from \$200,000,000. Two hundred millions would be a considerable sum to invest each year; and the accumulations of a quarter of a century would amount to the huge sum of five billions, even if the national wealth remained stationary

¹ Statisticians are not agreed as to the proper coefficient to be employed in calculating the total wealth of a nation from the annual transfer of wealth on account of death. The coefficients actually employed vary from 32 to 37. In calculating from the current estimate of total wealth the amount of annual inheritances I have used the coefficient $\frac{1}{8}$ as one which would give conservative results.

² Spahr, *The Present Distribution of Wealth in the United States*, p. 69, estimates that one-half the wealth of the United States is held in estates of \$50,000 and over. This estimate, which may have been deemed radical when it was made, twenty years ago, would today be considered moderate.

in amount. If the wealth of the country doubles in the next twenty-five years, as it probably will, we have to increase that amount to seven and one-half billions, if we wish to form a true estimate of the results of twenty-five years of accumulation of the tax.

These accumulations appear large and unwieldy when considered in themselves. When we view them in their proper relation to the capacity of our economic system to absorb new funds, however, their appeal to our apprehensions loses most of its force. The present annual increase in the indebtedness of the states, municipalities, and other minor civil divisions can scarcely be less than \$100,000,000, and, with the growing popularity of the policy of public ownership, we must expect to see this indebtedness increase at a still more rapid rate in the future. It is freely prophesied by economists of high repute that the United States will, in the end, nationalize its railways. Were we to levy inheritance taxes at the heaviest rates that are practicable, and set aside the entire proceeds of the tax for this purpose, it would require half a century to substitute public for private ownership of the bonds that would have to be issued in the process of buying out private interests in the field of transportation. There is no reason for confining public investment to public and semi-public enterprises; but even if we were to do so, we should never be embarrassed by any tendency of the supply of funds to outrun the demand.

Nor is there the least reason for fearing that the fund would attain such magnitude as to produce embarrassment in the disposition of the income from it. Assume that at the end of twenty-five years the accumulated fund would amount to seven and one-half billions; that sum at 3 per cent would yield a revenue of \$225,000,000—a very respectable contribution to the relief of old age and disability, perhaps, but certainly not in excess of the needs of that one service. The fund would doubtless increase more rapidly than the needs of that particular service; but long before it could reach such proportions as to provide income in excess of all social service requirements, the yield of the tax would probably have begun to decline on account of the disappearance of many of the inequalities in the distribution of wealth which characterize the present economic order.

Defenders of an economic system based upon the principle of private property must admit that at two points their position is decidedly weak: the private enjoyment of funded income, and the private burden upon the worker of mischances against which it is impossible for him to make provision. The private recipient of an absolutely secure funded income is freed from the necessity of exercising the skill and foresight which serve, in general, as an ethical basis for the defense of private property. The active manager of an industrial capital finds his position morally weakened by the fact that his property income is assimilated, in the social consciousness, to that of the functionless "remittance man." However much we may approve of the policy of throwing upon each able-bodied man the responsibility for finding means of self-support, we must admit that hundreds of thousands of our workingmen are exposed to chances against which they can make no adequate provision. For hundreds of thousands of our city workers, the only escape from an indigent old age is premature death. For hundreds of thousands of families, the death of the chief breadwinner means the maiming of children's lives almost past recovery. A system which permits such evils is surely not free from moral weakness. Now, the general tendency of the policy which I propose is to divert to the state part of the funded income of society from the private recipients in whose hands it subserves no useful purpose, and to charge upon it precisely those burdens by which the weak are now crushed. Not by the rough method of expropriation, however, but by a method which is legal as well as ethical, and which entails no sacrifice of the future to present gain. The public capitalization of inheritance taxes would result in an accumulation of funds which would be gradual, and it would hence leave opportunity for the development of efficient means of administration. Under this plan public accumulations would constantly increase; but their increase could never become so great as to restrict the field of private property unless private accumulations should come to a standstill and opportunities for private exploitation should fail.

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